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TAXATION AND THE ARTS, a brief

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THE CANADA COUNCIL

BRIEF ON TAXATION AND THE ARTS

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THE CANADA COUNCIL

BRIEF ON TAXATION AND THE ARTS

INTRODUCTION

1. The Canada Council's general concern with the arts is based upon the quality of the contribution individual artists and arts organizations make to the welfare of our society. In this particular report which lies a little outside our more normal pre-occupations we are concerned with their status in the financial structure of the country and in the quantitative contribution that they are now required to make to it by means of taxation. (The tenor of this report is that as economic entities the artists and arts organizations are asked to do more than should be expected of them; its purpose is to show where the law seems to require them to do this and how the burden might be lightened.) In fact through daily contact with the artistic community and meetings with its representatives, the Council has long found that among the problems they have to face, one of the most vexing is taxation which in their view does not recognize the special conditions under which the arts operate nor their status in the community.
2. The widespread dissatisfaction on this account led the Council to carry out a comprehensive review of current tax legislation as it affects artists and the arts, in the hope that specific proposals could be formulated towards alleviating the proportionately heavier burden placed upon them as well as stimulating the development of the arts. In the process, a team of tax experts

was commissioned to survey the field and to hold further consultations with the artistic community. This report rests largely on their findings and recommendations.

3. It is clear that the Council's primary concern is for the artists and arts organizations although some of the proposed changes to existing tax legislation should normally affect other categories of taxpayers as well. In the Council's view it is altogether too rare that the artistic community finds an authoritative body to speak on its behalf.

4. A review has been made of the proposals suggested by the report of the Royal Commission on Taxation (the Carter Report) and whenever our recommendations relate to subjects discussed in that report, reference will be made to the treatment it has given them. In addition, the tax treatment of the arts and artists in other countries has been examined.

5. In view of the frequent use which is made of the terms "charitable", "the arts" and "artist" throughout this report, we wish to guide the reader as to the proper interpretation which should be given to them. The word "charitable" is not to be understood in the sense of its everyday usage, but only in its much broader legal definition. In our view, support of the arts by individuals and corporations involves the discharge of important social obligations as well as the pursuit of enlightened self-interest. It is not "charitable" in the popular, rather patronizing, sense of the word.

6. In turn, the word "arts" is used in this report in the widest sense, as defined by the Canada Council Act. Also the word "artist" is not to be taken in the common, more limited sense, as someone practicing the visual arts. We do not believe that the lack of more precise definitions of these complex concepts "artist" and "the arts"

should be any obstacle to the adoption of the recommendations made in this report.

7. Finally, the need for evaluating works of art, musical instruments, artistic material and equipment will be apparent in several parts of the report dealing with various types of taxes and duties. Hence the importance of establishing an appropriate evaluation procedure where a market price is not immediately available or when the value quoted is not precise enough to answer the requirements of a specific situation. For instance, since sculptures worth \$75 or more are exempt from customs duties, an elaborate system of appraisal would be unnecessary for a work reputed to be worth a much larger sum; however, a more exact figure will have to be reached to meet the requirements of the legislation dealing with gift taxes and succession duties.

8. The Council is of the opinion that it should not be too difficult to develop a generally satisfactory procedure since expertise is available throughout Canada at the many public artistic and cultural institutions and at commercial dealers. It is essential, of course, that those selected to make evaluations for taxation purposes not be subject to conflicts of interest. We suggest rather that the evaluation process include artistic experts as well as commercial dealers in the related field. If the need arises, taxation authorities could seek the advice of the Canada Council as to where reliable persons could be found to give an independent evaluation. There is, moreover, an international market for works of art which could serve as a useful means for establishing values of arts objects. Finally, the Canadian Art Dealers' Association is the equivalent in this

country of the American Art Dealers' Association, whose members have been consulted from time to time in working out procedures acceptable to the United States Internal Revenue Service.

9. Our recommendations are of two kinds. Some are aimed at achieving comparable treatment with other groups of taxpayers; others indicate what could be done to provide incentives for the development of the arts and the improvement of the climate in Canada for artists and arts organizations, including a wider public participation.

I - INCOME TAXES

A - INCOME AVERAGING

10. The present provisions of the Canadian Income Tax Statutes should, in our opinion, be amended to provide relief from the adverse tax consequences arising from fluctuating incomes. It is, therefore, recommended that the income tax legislation, both federal and provincial, be amended to permit the averaging of income over a period of five consecutive years with the provision that a taxpayer be permitted to average his income over fewer years if he should so elect. This recommendation is identical with the block averaging election that has been suggested by the Royal Commission on Taxation and the Council endorses the Commission's recommendation without qualification. Such relief, which we believe should be accorded to all categories of taxpayers in Canada, would be a great benefit to several categories of artists whose incomes fluctuate considerably from year to year.

11. It is the nature of some arts that a long period of work may take place with no immediate income, to be followed by a period of fairly high income. A painter, for instance, may require a period of a year or more to prepare a large exhibition of his work and may earn little or nothing during this time. When the exhibition opens some of the work may sell quite rapidly and the remainder more slowly in succeeding months. In one theatre season an actor may be offered only a small number of roles, but in a following season chance may bring him a succession of leading roles and consequently a much higher income. In these cases (and others could be cited) the artist is defenceless against the tax consequences of his work.

12. At the present time, the right to average income is extended to farmers, fishermen and, under certain conditions, to authors. In our

view, the creation of a special status in this way is not an ideal tax policy and this is why we believe that right should be extended to everyone. However, if only a limited extension were acceptable, we would still favour applying it to artists whose income pattern is very similar to the groups now exempted.

13. One of the basic features of the Canadian income tax system is the progressive rate structure applicable to annual taxable income of individuals. Under this feature, as an individual's income increases the rate of tax applicable to the increment in income also increases. For example, the Federal Income Tax Act imposes a basic rate of 11% on the first \$1,000 of taxable income and of 14% on the next \$1,000 of taxable income. The progression in the rate structure continues until a maximum rate of 80% is attained on taxable income in excess of \$400,000 per year.

14. One of the results of the progressive rate system in Canada is that two individuals with the same total taxable income over a given number of years may pay different amounts of income tax. The individual whose taxable income fluctuates considerably from year to year will pay more tax than an individual whose taxable income remains relatively constant. In fact, the greater the fluctuation in income over such a period of years the greater the disparity is likely to be.

15. Present federal tax legislation recognizes only to a limited extent the unfair burden which can result from the receipt of lump sum amounts or from fluctuating incomes. Generally, the only alleviating provision that assists artists is the one permitting an author to spread income from the sale of copyrights over a period of prior years.

16. We are of the view that because artists are not permitted to average their income over a period of years, they are often subject to

undue hardship. The absence of such averaging provisions encourages persons to attempt to manipulate the timing of their receipts of income so as to minimize the tax impact on fluctuating incomes.

B - DEDUCTIBILITY OF ARTISTS' EXPENSES

17. It is the Council's view that all expenses incurred by an artist for the purpose of earning his income should be allowed in computing his income subject to tax, whether that artist is in business for himself or is an employee. The Council therefore recommends that existing provisions for deductible expenses be extended to those whose incomes consist of salaries and wages. This general attitude has also been taken by the Royal Commission on Taxation which recognizes that there is at present an unfair discrimination against employees. This change will benefit many performing artists on salary who are required to make certain necessary professional expenditures out of their own pockets. Although the Council shares the opinion of the Royal Commission on Taxation that the deductibility provisions proposed here should benefit all employees, it feels that artists, by the nature of their work, are particularly entitled to this treatment. More specifically, the part-time artist, who suffers seriously from present tax legislation, should be given the right to deduct all expenses involved in exercising his profession as an artist.

18. Under present tax legislation in Canada, "entrepreneurs" are entitled to deduct expenses incurred for the purpose of earning their income. On the other hand, employed artists cannot claim deductions for expenses incurred in earning their income. These expenses may include such items as clothing, travel, musical instruments, the cost of

materials used in paintings and sculptures, and similar expenditures.

19. The provisions of the Income Tax Act dealing with the deduction of expenses incurred for the purpose of earning income are numerous; however, the general provisions of Section XII (1) (A) established the general principle that:

"In computing income, no deduction shall be made in respect of an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the tax-payer."

20. The foregoing provision makes no mention of expenses incurred for the purpose of earning income from employment.

21. Part-time but nevertheless recognized artists whose main earning capacity is not in the field of art are not permitted to offset expenses incurred in connection with their artistic performances against salary income earned from their bread-winning occupation. For a great many artists it is an economic necessity to earn a salary from positions such as teaching. At the same time, these artists may be devoting themselves quite seriously to their art and, particularly in the earlier years of their career, may incur substantial expenses in doing so. Not only are they unable to deduct these expenses against their total income, including their salary income, they are also unable to carry them forward for deduction in subsequent years when they may have substantial revenues from their artistic endeavours.

22. The Council endorses the proposal of the Royal Commission on Taxation that, to reduce the administrative problem of checking expenses claimed, the taxpayer should be given the option of accepting a certain prescribed percentage of gross employment income with a dollar limit.

An employee with deductible expenses in excess of the percentage deduction would still be entitled to deduct the actual expenses incurred.

23. It is also the Council's view that tuition fees paid to schools in the arts in Canada or to any educational institution in which an artist or a student of the arts is pursuing his studies or practicing his art should be deductible for income tax purposes. Such fees are not deductible now.

24. The Council therefore recommends that the provision of Section 11 (1) (qc) of the Federal Income Tax Act be broadened to permit the deduction of tuition fees to schools in the arts and of master's fees paid by artists in the learning of their art. These are not within the ambit of the present section of the statute.

C - CHARITABLE DONATIONS

i) Limit of deductibility and instalment giving

25. The Council recommends that the present provisions of the Income Tax statutes dealing with the deductibility of charitable donations be amended to permit a deduction of up to 20% in respect of both individuals and corporations, with a further provision that charitable donations in any one year in excess of the maximum be permitted to be carried forward and allowed as deductions during the five years following the year in which the donation is made. A taxpayer who elects to average his income should be entitled to a maximum deduction of 20% of the "average" for any one year. The Council is of the view that the present federal limitation of 10% on charitable donations is too restrictive and has hindered the development of the arts in Canada.

26. Even if only a relatively small proportion of the benefits of this increased deductibility were to go to cultural or artistic organizations, the amounts would probably be substantial and of significant effect. A relatively small number of wealthy individuals and large corporate taxpayers in Canada make contributions up to the present maximum limits. They might well be induced to contribute even larger amounts if the limits were raised, and our impression is that these are the people and corporations most likely to give to the arts. For this reason our recommendation on the subject of deductibility for income tax purposes goes beyond what was suggested by the Royal Commission on Taxation. Although the Commission stated its admiration for those who habitually make charitable donations in excess of ten percent of their income and reported that eloquent representations were made on their behalf, it recommended that no change be made in the present 10% limit for corporations and that the limit on donations for individuals be raised to 15% but only after certain administrative procedures have been put into effect.

27. Cultural organizations such as ballet and opera companies, art galleries and theatres, generally appeal much less to prospective donors than do such charitable organizations as hospitals, schools, universities and health and welfare groups. Cultural organizations receive only about 2% of all charitable donations made by corporations in Canada, with the other 98% going to other kinds of charitable institutions. Most of the charitable contributions made by individuals in Canada follow a similar pattern.

28. Most arts organizations prefer to appeal for large donations in support of specific projects or acquisitions to those donors who

have special interests in the field. They are often informed that the prospective donors have already reached their 10% limit and that anything additional would not be deductible. For example, when an opera company needs a special donation to mount a new production, it may be hampered in its efforts by the 10% limit. The same holds true for an art gallery or a museum which wishes to acquire valuable works of art. If the value of the prospective donation exceeds the maximum amount deductible, it might not be made.

29. Under the present income tax legislation the deductibility of donations once made cannot be spread over more than two years. Recently, an individual wished to donate an important painting to a gallery, but did not do so since its value was considerably in excess of his maximum deductibility. Collections have been given to art galleries in the past over a period of time on a piecemeal basis in order to stay within these maximum limits. This, however, cannot be done with a single work of art of great value. To facilitate and to encourage donations of valuable works of art and to encourage donations to specific artistic causes as these arise from time to time, it is recommended that taxpayers be allowed to deduct the donation up to the limit of 20% in the year of the donation, and that they be permitted to carry forward any excess for deduction during the five following years.

30. The Council is aware that there are still a few artistic organizations which have not elected to operate as "charitable" institutions in the broad sense given by existing legislation. Since revenue departments will accept as deductible only those donations made to legally accepted charitable institutions, there is obviously

a good reason for such organizations to revise their existing legal status. However, a few important arts organizations are prevented from enjoying the status of "charitable" institutions because of the special nature of their activities (e.g. cultural publications).

The Council believes that they should not be discriminated against in this way.

31. There seems to be a popular belief that deductible contributions relate primarily, if not exclusively, to donations made to institutions looking after the socially disadvantaged people as the word "charitable" interpreted in its narrowest sense would suggest. Instructions issued by revenue departments to taxpayers should make the public more aware that similar benefits may be obtained from donations to the arts.

ii) Full deductibility for public collections

32. A serious problem exists in connection with gifts to museums and galleries. The National Museums of Canada in Ottawa are a Crown Corporation. Under the provisions of the Federal Income Tax Act, any gifts made to it are not subject to the normal 10% limit on charitable donations. Following recent legislation, museums and art galleries owned by provincial governments now enjoy similar privileges. Therefore, taxpayers may deduct the full value of gifts made to Her Majesty in right of a province, as well as to Her Majesty in right of Canada up to 100%. However, this legislation places galleries and museums that are not owned directly by the federal government or by a provincial government in an inferior position with regard to the acquisition of works of art. Among this group are such major institutions as the Montreal Museum of Fine Arts and the Vancouver Art Gallery.

33. The Council certainly gives full support to the view that the building up of our national treasures warrants the 100% deductibility now allowed for contributions to museums and galleries owned by provincial and federal governments. However, the Council believes that this special deductibility provision should also serve museums and galleries not owned by the government but which answer similar public needs. One method of achieving this objective might be to form a National Arts Collection Trust which would act as an agency of the Crown. The value of paintings and other works of art which would be received by the Trust and turned over to galleries and museums of the donor's choice would not be subject to the deductibility limits prescribed by the Income Tax Statutes. However, if the setting up of the National Arts Collection Trust does not prove to be an acceptable solution, we suggest that the deductibility privilege now benefiting government owned museums and galleries only, be extended to non-governmental institutions which serve the same purposes.

iii) Gifts in kind

34. The Council recommends that all gifts in kind valued in excess of \$500 made to a qualified organization should be fully deductible in arriving at the donor's taxable income provided that the gift is such as to serve the purpose of the recipient. The Council further recommends that adequate professional evaluation procedures along the lines described in the introduction be established to facilitate the evaluation of gifts in kind. It should be pointed out that the Royal Commission on Taxation recommended that outright gifts in kind to charitable organizations to the extent of the excess over \$500 in any year should qualify as charitable donations. The Council believes, however, that the Royal

Commission's recommendation does not go far enough to encourage the transfer of valuable artistic assets from private hands to public institutions and thus recommends that the full amount of gifts which are in excess of \$500 be deductible.

35. The Income Tax Act provides that a taxpayer may deduct from income "gifts made by the taxpayer in the year", subject to certain conditions, provided that the "payment of the amounts given is proven by filing receipts with the Minister". Due to a restrictive interpretation of the foregoing provision by officials in the Department of National Revenue, it has been the practice of the Department to recognize only gifts which were made in cash and not gifts in kind. A directive issued by the Department of National Revenue on September 9, 1948 stated "the donations must be in money". In a judgment of the Tax Appeal Board in 1955, the then chairman of the Board stated:

"It has also been established that gifts made in kind instead of cash are not deductible in practice on account of the problem of correct valuation. It would be difficult to prove 'payments of the amounts' under the strict language of the Section."

However, notwithstanding the language of this particular judgment, the present provisions of the Income Tax Act clearly contemplate the deductibility of "gifts made by the taxpayer".

36. While it is understood that in certain cases the Department of National Revenue allows a deduction of an amount equal to the fair market value of charitable contributions made in kind, the earlier prohibition against such gifts has clouded the issue and created considerable confusion and uncertainty. The Council was informed that where gifts in kind to a gallery or museum are contemplated, the donor

will usually arrange to sell his work of art to the gallery or museum and at the same time undertake to donate cash of an equivalent amount to that institution. The Taxation Division's restrictive interpretation of the provisions of the Income Tax Act concerning gifts is undoubtedly due to the difficulty of administering them. However, this interpretation has caused taxpayers to suffer and discouraged donations in kind.

37. It is expected that in most cases the value of the works of art donated to galleries and museums would be dictated by the market. However, should the market price be at issue the procedure described in the introduction for the evaluation of these works should be followed.

iv) Life interests

38. The Council recommends that contributions to charitable institutions of future interests in works of art be deductible in arriving at the donor's taxable income. This would be an important factor in encouraging the transfer of works of art from private collections to museums where they can be seen by the public. A formula to determine the value of the life interest could be arrived at in order to calculate the amount which would be deductible at the time of the donation. Under this practice, the donor would retain life-time enjoyment of the property and a current deduction for the present value of the future interest.

39. The Council is convinced that the possibility which would be offered a taxpayer to deduct immediately the value of future interests in works of art would be attractive enough to encourage such donations. This measure would be particularly rewarding for Canada where it is not uncommon to find a legacy which results in the loss to this country of important works of art. Were the ownership of these works relinquished

to Canadian museums during the lifetime of the donor, the number of such unfortunate losses would be reduced.

D - PURCHASES OF WORKS OF ART

40. The Council recommends that there be no change in the present tax treatment accorded a work of art purchased by a business enterprise and placed on its premises. However, the Council has concluded that business enterprises generally are unaware of the tax benefits which can be derived from purchases of this kind and therefore, to create a better awareness of these advantages amongst the business community, the Council recommends that a specific provision be made in the income tax regulations to codify the present practices.

41. Generally, a work of art purchased by a business to be placed or located on its own premises can be depreciated for income tax purposes at a maximum rate of 20% on a reducing balance basis each year. However, the Taxation Division might resist a claim for capital cost allowance on an unusually expensive work of art on the grounds that the cost of acquiring it was not incurred for the purpose of earning income. While consideration was given to recommending that a business enterprise be entitled to a deduction of 100% of the cost of the work of art in the year of purchase, the Council nevertheless concluded that the present provisions are sufficient and generous. When one considers that the present income tax legislation provides that a business enterprise may claim capital cost allowance at various rates on its income earning assets, e.g. 20% on typewriters, desks and other furniture, it is difficult to rationalize that works of art should be entitled to a more accelerated write-off since it cannot be claimed

that works of art are more essential to the success of the business than are the income earning capital assets.

42. The Council is also of the view that sculptures, murals, architectural engravings and other artistic works incorporated into buildings or other structures should be eligible for depreciation for income tax purposes at a rate of 20% on a reducing balance basis.

Under the present provisions of the income tax statutes such artistic work is eligible for the same rate of depreciation as the building or other structure of which it forms part, - normally a rate of 5% to 10%.

43. It has been suggested that individuals should be permitted to deduct outlays made to purchase works of art and that this would result in a substantial increase in their sale. We do not think, however, that this would be appropriate since the purchase of a work of art by an individual results in the acquisition of a valuable personal asset while the same purchase by an enterprise to some extent keeps the work of art in the public domain.

II - SALES TAXES

A - FEDERAL SALES TAXES

44. The Council is of the view that the federal sales tax legislation should be changed or, in some cases, clarified to provide the following exemptions from sales tax:

- i) - All artistic and cultural organizations which qualify as charitable organizations under the Income Tax Act should be exempt from the federal sales tax on purchases made by them or on any sets, properties and costumes created by them.
- ii) - Individual artists should be exempt from federal sales tax both on purchases of materials used in the production of works of art and on sales of works of art.

45. Many of the arts organizations in Canada receive subsidies from the federal government through the Canada Council. By being required to pay federal sales tax on various purchases of materials and on costumes, properties and sets they create, these organizations, in effect, are required to refund a portion of the subsidy. It is realized that the concept of taxing government subsidies is not confined to this particular situation.

46. The Council recommends an unconditional exemption for such organizations on the grounds that they are non-profit organizations. It is our view that the exemption can be administered easily by the federal government merely by providing that all cultural organizations such as ballet, opera or theatrical groups which qualify as charitable organizations under the Income Tax Act be exempt from the federal sales tax.

47. Major ballet, opera and theatre companies making their own sets,

properties and costumes face substantial tax bills since their creation is assessed on the basis of the cost of materials and labour. For instance, the National Ballet spends approximately \$10,000 in sales tax each year; Les Grands Ballets Canadiens spends approximately \$7,500 and the Canadian Opera spends approximately \$7,000. The Stratford Shakespearean company has been required to pay sales tax considerably in excess of these amounts.

48. However, judging from a decision made recently by regional officers of the Department of National Revenue, it may be that tax legislation governing the cultural organizations which operate their own workshop is not as rigid as these were led to believe. For instance, after making representations to the appropriate officers of that Department, some arts organizations were told that the products of their costumes and wardrobe department were exempted from the manufacturer's sales tax because they were covered under section 2(4) in the following classes: milliners, shoemakers, merchant tailors and dressmakers. This suggests that the legislation should be clear enough to assure uniformity of application among similar groups. Furthermore, this exemption does not relieve them from the sales tax on purchases of materials. The Council recommends that cultural organizations be exempted on both counts.

49. Present sales tax laws include exemptions for most works of art provided that, in some cases, they meet a minimum value requirement. Thus, in order to be tax free a sculpture must be worth at least \$75 and a painting or drawing \$20. However, a special problem exists because of the increasing number of artists who produce several copies of one work. Under existing legislation, with the exception of

sculptures the first twelve replicas of which are also exempted from sales taxes, original models only are not subject to a sales tax. On this basis, engravers, etchers and other artists who normally produce several copies of one work will be required to pay a tax on the sale of their artistic products.

50. The Council's recommendations is that no tax be payable on the sale of any work of art, whether they be original models or replicas made from these models. In certain cases there might be some difficulties in determining whether a piece of work which has been reproduced a number of times is an actual work of art. However, we believe that the number of copies made can still be a reliable guideline to differentiate between the work of a professional artist and the product of commercial manufacture and this number of copies which could be considered as the demarcation line should be what is acceptable by the artistic community.

51. On the other hand, where no tax is levied on the sale of the products (originals and, in the case of sculptures only, the first twelve replicas) artists still have to pay a tax on the purchase of their materials. This, of course, imposes a heavy burden on many artists who use large quantities of expensive materials in the preparation of their works. The Council therefore recommends that artists be exempt from sales tax on the purchase of materials used in the production of their works of art, as well as on the sale of these works.

52. The Council is aware that, in certain cases, there have been difficulties in identifying works of art. This problem is not likely to be lessened. Quite the contrary, with the further diversification of materials used in the production of works of art it will become increasingly difficult to differentiate them from manufactured

goods. However, the Council is of the opinion that such difficulties could be resolved by the establishment of a proper evaluation process and that in no case should the artist suffer from a static interpretation of what a work of art is.

B - PROVINCIAL SALES TAXES

53. The Council suggests, in line with what has been said above, that all sales of works of art or purchases of materials for works of art should be exempted from provincial sales taxes.

54. It is difficult to justify the imposition of a retail sales tax on sales of works of art since the very concept of retail sales tax is that it is a tax on the use or consumption of goods. Works of art are of permanent and durable nature and there is no reason why they should be subject to a retail sales tax.

55. The removal of provincial sales taxes would be an incentive in several ways:

- a) it would effectively reduce prices of paintings, sculptures and other works of art, thus stimulating the market;
- b) it would encourage people to purchase works of art in the jurisdiction in which they reside; and
- c) it would greatly assist Canadian art dealers to improve their competitive position on the international market.

56. Provincial retail sales taxes are often avoided on the sales of works of art. The sales tax generally is collected only on local purchases and usually is not collected if purchases of works of art are made in a jurisdiction other than the one in which the purchaser resides. This practice contravenes the spirit of the sales tax legislation and

has the effect of penalizing local dealers and buyers. Canadian purchasers of American and European works who buy in New York, London or Paris escape sales taxes. These purchasers avoid the local sales taxes where they make their purchases (being non-residents of the country where the sale takes place) and do not pay provincial sales taxes when importing their purchases into Canada.

57. It should be pointed out that books are generally exempt from provincial sales taxes and it is difficult to accept a different sales tax treatment for works of art.

III - IMPORT DUTIES

58. It is the Council's recommendation that all works of art imported by Canadians be exempt from import duties and that all materials, supplies and equipment imported by Canadian artists or arts organizations for use in the arts be also exempt.

59. Many works of art are already exempt from import duties and these exemptions should be continued. For example, an exemption is made for paintings valued at not less than \$20 and sculptures valued at not less than \$75. On the other hand, several kinds of works of art are not included in the categories of objects which are specifically exempted from customs duties. For example, a painting imported in a frame is in theory taxable, while the same work of art imported without a frame is not. In practice, however, it is understood that this distinction is not invoked by customs officers.

60. Many items fall within a category described as "of a class or kind made in Canada" and are therefore subject to import duties even though they are not in fact made in Canada or, if they are made, do not always meet the specific requirements of the professional artist. Examples of such items are ballet shoes, musical instruments, musical scores, reconditioning of musical instruments, paints and painting materials.

61. Some of the examples where import duties cause specific problems merit close attention. Ballet companies and ballet schools spend substantial amounts each year on import duties and sales taxes for ballet shoes. These organizations use a large number of ballet shoes each year, which must be imported since Canada does not make them

in sufficient quality and quantity. No exemption is granted for ballet shoes since they come under the general tariff item of "Shoes" described as "of a class or kind made in Canada". The combined budgets for shoes of the National Ballet of Canada and Les Grands Ballets Canadiens amount to approximately \$50,000 per year.

62. The tariff schedules providing for exemptions on musical instruments are outdated; they do not include all the present day instruments which are being used by orchestras and individual performers today. Duties are payable on many types of musical instruments even though it is often impossible to purchase instruments of sufficient quality in Canada.

63. Many musical instruments need reconditioning at least once a year. In cases where the facilities in Canada are insufficient, the instruments must be sent abroad. When the instruments are returned, the reconditioning costs are dutiable at the same rates as the instruments themselves.

64. Symphonic and chamber orchestras often find it necessary to import many thousands of dollars worth of musical scores from abroad each year. The scores are simply not obtainable in Canada and are subject to a 33% duty rate.

65. As noted above, difficulties will undoubtedly arise in defining a work of art, particularly in view of the drastic technical changes which the traditional forms of art are undergoing. These difficulties can be overcome by consulting experts in the arts. Further, provisions should be made in the customs legislation to assure that all materials needed or used by artists in the exercise of their art may be imported duty free.

IV - ESTATE TAXES AND SUCCESSION DUTIES

A - BEQUESTS TO CHARITABLE ORGANIZATIONS

66. The Council recommends that, where applicable, steps be taken to amend the provincial succession duties acts to provide that the value of bequests to charitable organizations be deductible in arriving at the amount used as the base for determining the rate to be applied to taxable bequests.

67. In certain provinces, when an identifiable work of art is bequeathed to a qualifying charitable organization, the value thereof cannot be excluded from the base valuation of the estate although that bequest is exempt from tax. The base valuation is the amount used in determining the rate of duty to be applied to taxable bequests.

68. In as much as the succession duty rate structure calls for graduated rates as the value of the base increases, the inclusion in the base of gifts made to charitable organizations will result, in most cases, in greater taxes on taxable bequests.

69. There is no problem in excluding the value of works of art bequeathed to charitable organizations from estate taxes and provincial succession duty. The problem lies solely in the determination of the base value on which the appropriate succession duty rate is determined.

B - BEQUESTS OF LIFE INTERESTS IN WORKS OF ART

70. After consideration, it was decided to abandon a general proposal that the existing estate tax and succession duty legislation be amended to provide for full exemption from tax and duties of identifiable works of art bequeathed to a charitable organization subject to the passing of possession at some future date. However, the Council believes

that an exemption should be made in the case of the children of the deceased person. In such a case, full exemption should be granted.

71. Under the existing provisions of the Federal Estate Tax Act where a work of art is bequeathed to another person for life and thereafter to a museum, gallery or other charitable institution, a valuation must be placed on the life interest and the value thereof must be included in the valuation of the deceased person's estate.

72. Members of various charitable organizations have felt that this requirement has deprived them of bequests of works of art which they might otherwise have received. They point out that a testator faced with the prospect of leaving a future interest in a work of art to a gallery or museum, and having a part of its value included in his estate, will often decide to make the bequest directly to his beneficiary thus depriving the gallery or museum of a work of art which would otherwise have been available to it.

73. The adoption of this type of general exemption in Canada could represent a considerable reduction of revenues for governments. Nevertheless, to encourage bequests to charitable institutions of paintings, sculptures and other works of art, the Council recommends that works of art bequeathed to charitable institutions but subject to the passing of possession at some future date, be fully exempted from estate taxes and succession duties when the intermediate beneficiaries are the children of the donor, in the spirit of the exemption recently proposed by the Federal Government with regard to the spouse of the deceased. The Council also recommends that where provincial legislation is at variance with this, it be amended accordingly.

V - OTHER TAXESA - AMUSEMENT TAXES

74. The Council recommends that artistic performances which are subsidized by any level of government be exempt from amusement taxes. In some cases, an art organization receiving a municipal subsidy pays back as much, or more, in amusement taxes. This situation is aggravated by the adverse effects on attendance from an increase in ticket prices caused by an amusement tax. We believe that the possible difficulties of administration would be kept to a minimum if exemptions were granted only to performances supported by a government programme of assistance to the arts.

B - GIFT TAXES

75. There would appear to be no reason to amend the present gift tax provisions which, we might add, are contained only in the Federal Income Tax Statute and are not imposed at the provincial level. Under the existing provisions a taxpayer may make a gift (as distinct from a charitable donation) to another person (who is usually a relative) and, depending on the amount or value of the gift, may be exposed to the imposition of gift taxes thereon. Certain basic exemptions are allowed. A work of art given to another person would require valuation at fair market value and gift taxes would be payable on the excess of this value over the appropriate amount of exemption permitted by the Income Tax Act. There appears to be no evidence that the existing gift tax provisions are detrimental to the arts and since these provisions have a neutral effect, we can see no reason for changing them.

VI - SPECIAL INCOME TAX ALLOWANCE
FOR CAPITAL EXPENDITURES ON THE ARTS

76. Over the past several years, and in particular during Centennial Year, there has been a substantial growth in the amount of cultural activity in the country. Expo 67 and various centennial projects have added to the country's store of arts centres, theatres, music halls, etc., and have aroused considerable public interest in the arts in Canada.

77. However, it is the Council's view that Canada is still lagging behind several other countries, notably the United States and most European countries, with regard to what might be called our stock of cultural assets and facilities which should be taken to include materials such as sets and costumes used by organizations. It is debatable whether appropriate buildings are now available to house the performing arts, but there is ample evidence that museums and art gallery accommodations are inadequate to serve the needs of the visual arts. The lack of cultural facilities can be illustrated equally well by the shortage of new and original productions in the repertoire of our opera and ballet companies. In order to foster a rapid enlargement of these cultural assets, the Council believes that it may be practical to use our tax laws to stimulate a large scale capital spending programme for the arts.

78. Accordingly, the Council recommends that income tax legislation be amended to provide for a deduction from income of 150% of the amount of gifts or donations made to approved "arts projects" of a capital nature.

79. Over the years the Federal Income Tax Act has been used repeatedly as a fiscal vehicle for providing incentives for various

purposes. Recently, to stimulate scientific research, the Government provided a special deduction of 150% of the amount spent thereon in Canada under certain prescribed conditions. The results were somewhat short of expectations, in part because of ambiguities of drafting and of interpretation, but we believe that a similar scheme in the field of the arts would have a significant impact.

80. The programme we suggest would:

- a) be a recognition by the government of the country's cultural needs and, as a matter of national policy, an expression of its wish to stimulate projects which will help catching up with other countries;
- b) place initiative for projects in the hands of the public;
- c) encourage the application of accumulated private earnings to desirable social use.

81. It may be argued that an incentive of these dimensions can only be justified on a relatively temporary basis. Moreover, it is recognized that the deduction may serve its purpose more rapidly if it is available for a limited period of time rather than indefinitely.

Therefore, we suggest that as an initial experiment, the 150% deduction be implemented for five years. Deductibility should be equally available for single payments or those made by instalments over the permissible period. Some advance notice, such as a year or possibly a shorter period, should be offered to achieve the best results.

Capital projects and public campaigns for their support require some reasonable time for effective planning and implementation.

82. / Essentially, the type of projects envisaged should be of a capital nature. Expenditures to cover the cost of materials in the

production of new operas, plays and ballets would qualify for the 150% deduction proposed on the same basis as outlays made towards museums, opera houses, art galleries, cultural centres, or other similar projects. Extension of existing facilities should equally qualify. Contributions of important works of art and other objects to furnish or adorn such centres should also be eligible. In order to be accepted for deductibility purposes, a project would have to be undertaken by a professional non-profit organization and, in the case of buildings, would need government sponsorship.] Where provincial as well as federal tax measures are involved every effort should be made by advance consultation between the appropriate authorities to synchronize the incentives so that they are available on a similar or corresponding, though not necessarily identical, basis in both jurisdictions.

83. With the corporate tax rate at a little over 50%, even a 150% degree of deductibility entails some appreciable contribution of funds which would otherwise remain within the private sector of the economy. For individuals whose marginal personal income tax rates may rise as high as 80%, some limitations are necessary to ensure that contributions do not have the effect of actually increasing residual income after taxes and after the special deduction. While some tenable arguments might even be made to the contrary, we are also of the view that at least some element of private generosity must be involved. Hence, we propose that a limit be established so that taking advantage of the special deductibility provision does not result in an increase of the residual income after taxes and leaves room for an element of private generosity.

84. Some question may be raised as to whether, in any event, there should be additional limitations related to a maximum percentage - such as 30% - of total taxable income. For our part, we consider that the cultural lag to be overcome requires so much correction that this particular incentive should not be diluted in this manner. In any event, it should not impinge upon, or affect, deductibility for charitable contributions generally.

SUMMARY OF RECOMMENDATIONS

THE COUNCIL RECOMMENDS THAT:

- 1 - the income tax legislation, both federal and provincial, be amended to permit the averaging of income over a period of five consecutive years with the provision that a taxpayer be permitted to average his income over fewer years if he should so elect. The Council believes that right should be extended to everyone. However, if only a limited exemption were acceptable, it would still favour applying it to artists whose income pattern is very similar to the groups now exempted. (Para. 10-16)
- 2 - existing provisions for deductible expenses be extended to those whose incomes consist of salaries and wages. Although the Council shares the opinion of the Royal Commission on Taxation that these deductibility provisions should benefit all employees, it feels that artists, by the nature of their work, are particularly entitled to this treatment. (Para. 17-22)
- 3 - the provision of Section 11 (1) (qc) of the Federal Income Tax Act be broadened to permit the deduction of tuition fees to schools in the arts and of master's fees paid by artists in the learning of their art. (Para. 23-24)
- 4 - the present provisions of the Income Tax statutes dealing with the deductibility of charitable donations be amended to permit a deduction of up to 20% in respect of both individuals and corporations, with a further provision that charitable donations in any one year in excess of the maximum be permitted to be carried forward and allowed as deductions during the five years following the year in which the donation is made. (Para. 25-31)
- 5 - the 100% deductibility provision allowed for contributions to museums and galleries owned by provincial and federal governments should also serve museums and galleries not owned by the government but which answer similar public needs. (Para. 32-33)
- 6 - all gifts in kind valued in excess of \$500 made to a qualified organization should be fully deductible in arriving at the donor's taxable income provided that the gift is such as to serve the purpose of the recipient. The Council further recommends that adequate professional evaluation procedures along the lines described in the introduction be established to facilitate the evaluation of gifts in kind. (Para. 34-37)

- 7 - contributions to charitable institutions of future interests in works of art be deductible in arriving at the donor's taxable income. (Para. 38-39)
- 8 - there be no change in the present tax treatment accorded a work of art purchased by a business enterprise and placed on its premises. However, the Council has concluded that business enterprises generally are unaware of the tax benefits which can be derived from purchases of this kind and therefore, to create a better awareness of these advantages amongst the business community, the Council recommends that a specific provision be made in the income tax regulations to codify the present practices. (Para. 40-41)
- 9 - sculptures, murals, architectural engravings and other artistic works incorporated into buildings or other structures should be eligible for depreciation for income tax purposes at a rate of 20% on a reducing balance basis. (Para. 42-43)
- 10 - all artistic and cultural organizations which qualify as charitable organizations under the Income Tax Act should be exempt from the federal sales tax on purchases made by them or on any sets, properties and costumes created by them. (Para. 44-48)
- 11 - individual artists should be exempt from federal sales tax both on purchases of materials used in the production of works of art and on sales of works of art. (Para. 44 and 49-52)
- 12 - all sales of works of art or purchases of materials for works of art should be exempted from provincial sales taxes. (Para 53-57)
- 13 - all works of art imported by Canadians be exempt from import duties. (Para 58-65)
- 14 - all materials, supplies and equipment imported by Canadian artists or arts organizations for use in the arts be also exempt from import duties. (Para. 58-65)
- 15 - where applicable, steps be taken to amend the provincial succession duties acts to provide that the value of bequests to charitable organizations be deductible in arriving at the amount used as the base for determining the rate to be applied to taxable bequests. (Para 66-69)
- 16 - works of art bequeathed to charitable institutions but subject to the passing of possession at some future date, be fully exempted from estate taxes and succession

duties when the intermediate beneficiaries are the children of the donor, in the spirit of the exemption recently proposed by the Federal Government with regard to the spouse of the deceased. The Council also recommends that where provincial legislation is at variance with this, it be amended accordingly. (Para. 70-73)

- 17 - C artistic performances which are subsidized by any level of government be exempt from amusement taxes. (Para. 74)
- 18 - X (income tax legislation be amended to provide for a deduction from income of 150% of the amount of gifts or donations made to approved "arts projects" of a capital nature. The Council further suggests that as an initial experiment, the 150% deduction be implemented for five years. (Para. 76-84)

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